



CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

September 12, 1997

H.R. 10 **Financial Services Competition Act of 1997**

*As reported by the House Committee on Banking and Financial Services
on July 3, 1997*

SUMMARY

H.R. 10 would abolish the federal thrift charter, thus allowing the merger of the bank and thrift insurance funds, and would eliminate certain barriers to ties between insured depository institutions and other financial and commercial firms. While these changes could affect the government's spending for deposit insurance, CBO has no basis for predicting whether the long-run costs of deposit insurance would be higher or lower than under current law. Because insured depository institutions pay premiums to cover these costs, any such changes would have little or no impact on the budget over time. CBO estimates that implementing the bill would increase other direct spending by \$4 million in 1998 and \$62 million over the 1998-2002 period, and would decrease revenues by \$1 million in 1998 and \$17 million over the 1998-2002 period. Assuming appropriation of the necessary amounts, CBO estimates that several agencies would spend between \$3 million and \$4 million annually to carry out the provisions of the bill, once fully implemented. Because H.R. 10 would affect direct spending and receipts, pay-as-you-go procedures would apply.

H.R. 10 contains several intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that the costs of complying with these mandates would total less than \$10 million annually and thus would not exceed the threshold established under that act (\$50 million in 1996, adjusted annually for inflation). H.R. 10 also contains several private-sector mandates as defined in UMRA. CBO's estimate of the cost of those private-sector mandates is detailed in a separate statement.

DESCRIPTION OF THE BILL'S MAJOR PROVISIONS

H.R. 10 would:

- require all federally chartered savings associations to convert to a national bank or state charter within two years after date of enactment, merge the Office of Thrift Supervision (OTS) with the Office of the Comptroller of the Currency (OCC), and allow the merger of the Savings Association Insurance Fund (SAIF) and the Bank Insurance Fund (BIF);
- permit affiliations of banking, securities, and insurance companies;
- with certain revenue limitations, allow non-banking commercial firms to own small banks through a well-capitalized holding company and allow bank holding companies to own commercial firms;
- provide for a new type of wholesale financial institution that does not accept retail insured deposits, known as a “woofie”;
- create a 10-member National Council on Financial Services (NCFS), comprising representatives from state and federal regulatory agencies; the NCFS would determine which products offered by banks and other providers of financial services are financial in nature, would identify the appropriate regulator for these products, and would regulate disputes involving the definition of these products;
- reform the Federal Home Loan Bank (FHLB) System, making membership voluntary; limit FHLBs’ investments only to those necessary for liquidity, safety and soundness, and housing finance; and replace the \$300 million annual payment made by the FHLBs for interest on bonds issued by the Resolution Funding Corporation (REFCORP) with an assessment set at 20.75 percent of the FHLBs’ net income;
- require insured depository institutions and their subsidiaries to adopt a number of consumer protection measures affecting sales of nondeposit products;
- require the General Accounting Office (GAO) to report annually on market concentration in the financial services industry;
- amend the Securities Exchange Act of 1934 to define bank employees or bank affiliates as “brokers” if they conduct certain activities; and

- shift from the financial regulatory agencies to the Department of Justice (DOJ) the authority to review the competitive effects of the antitrust laws involving mergers of depository institutions.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

H.R. 10 would make a number of changes affecting direct spending and revenues, which would result in increased spending by the banking regulatory agencies and the FHLBs, and a decrease in the annual payment—recorded as revenues—that the Federal Reserve remits to the Treasury. CBO estimates that direct spending would increase by about \$62 million over the 1998-2002 period. We estimate that enacting H.R. 10 would decrease revenues by \$17 million over the same period. The bill also would increase discretionary spending by an estimated \$14 million over the 1998-2002 period, assuming appropriation of the necessary amounts. The estimated budgetary impact of H.R. 10 is shown in the following table.

The budgetary effects of this legislation on outlays fall within budget functions 370 (commerce and housing credit) and 900 (interest). The legislation would also affect revenues (governmental receipts).

BASIS OF ESTIMATE

Direct Spending and Revenues

H.R. 10 could affect direct spending for deposit insurance by increasing or decreasing amounts paid by the insurance funds to resolve insolvent institutions and to cover the administrative expenses necessary to implement its provisions. Changes in spending related to failed banks and thrifts could be volatile and vary in size from year to year, but any such costs would be offset by insurance premiums, and thus their budgetary impact would be negligible over time. The bank regulators would also incur expenses related to the proposed legislation, but not all of these costs would be offset by fees. The contribution the FHLBs make to pay interest on REFCORP bonds would increase, thus reducing the Treasury payment to REFCORP. Finally, H.R. 10 also would affect revenues by reducing annual payments from the Federal Reserve to the Treasury.

	By Fiscal Year, in Millions of Dollars					
	1997	1998	1999	2000	2001	2002
DIRECT SPENDING						
Spending Under Current Law ^a						
Estimated Budget Authority	2,328	2,328	2,328	2,328	2,328	2,328
Estimated Outlays	-10,152	-1,934	-526	1,160	1,845	2,038
Proposed Changes						
Estimated Budget Authority	0	0	-22	-17	-4	-1
Estimated Outlays	0	4	8	11	18	21
Spending Under H.R. 10 ^a						
Estimated Budget Authority	2,328	2,328	2,306	2,311	2,324	2,327
Estimated Outlays	-10,152	-1,930	-518	1,171	1,863	2,059
CHANGES IN REVENUES						
Estimated Revenues ^b	0	-1	-4	-4	-4	-4
CHANGES IN SPENDING SUBJECT TO APPROPRIATION						
Estimated Authorization Level	0	1	3	3	3	4
Estimated Outlays	0	1	3	3	3	4

a. Includes spending for deposit insurance activities (subfunction 373) and Treasury payments for interest on REFCORP bonds.

b. Includes changes in the Federal Reserve surplus. A negative sign indicates a decrease in revenues.

Deposit Insurance Funds. Enacting H.R. 10 could affect the federal budget by causing changes in the government's spending for deposit insurance, but CBO has no clear basis for predicting the direction or the amount of such changes. Changes in spending for deposit insurance could be significant in some years, but would have little or no net impact on the budget over time.

Title III would convert to national banks all federal savings institutions in existence within two years of the date of enactment, thus allowing the merger of the BIF and the SAIF. Both funds hold reserves in excess of the levels mandated by statute, and thus the combined fund would be well-capitalized initially. The SAIF insures far fewer and more geographically concentrated institutions than does the BIF, and those institutions focus on housing finance.

A combined insurance fund thus could benefit from diversifying geographic and product risks that could lower the probability that the fund would become insolvent.

Other provisions in the bill could affect spending by the deposit insurance funds. Some are likely to reduce the risks of future bank failures. For example, H.R. 10 would permit affiliations of banking, securities, and insurance companies, thereby giving such institutions the opportunity to diversify and to compete more effectively with other financial businesses. Changes in the marketplace, particularly the effects of technology, have already helped to blur the distinctions among financial service firms. Further, regulatory and judicial rulings continue to erode many of the barriers separating different segments of the financial services industry. For example, banks now sell mutual funds and insurance to their customers and, under limited circumstances, may underwrite securities. At the same time, some securities firms offer checking-like accounts linked to mutual funds and extend credit directly to businesses. Because H.R. 10 would streamline the regulatory and legal structure that currently governs bank activities, CBO expects that its enactment would allow banks to compete more effectively in the rapidly evolving financial services industry. Diversifying income sources also could result in lower overall risks for banks, assuming that the expansion of their activities is accompanied by adequate safeguards. The bill would create “firewalls” to protect the banking components of a financial services organization from its riskier securities, insurance, or other financial activities, and would prohibit or limit certain transactions between banks and affiliates, hopefully preventing financial and informational abuses and conflicts of interest.

H.R. 10 also would allow banks to expand into relatively unfamiliar activities, thus possibly increasing the risk of bank failures. The bill would allow two approaches that would mix banking and commerce. Well-capitalized and healthy bank holding companies could own commercial firms as long as the aggregate commercial revenues do not exceed 15 percent of the holding company's gross domestic revenues. It also would allow a commercial firm to control a bank holding company with one small bank (less than \$500 million in assets). Similarly, revenues from the bank could not exceed 15 percent of the consolidated gross domestic revenues of the commercial firm.

But, permitting insured banks to diversify into product areas where they have little experience, or allowing commercial firms to own banks, raises questions about the adequacy of the regulators’ ability to protect the insured entities and the insurance funds. Several federal banking regulators have expressed uncertainty about their ability to maintain adequate safeguards between the transactions of the insured institutions and their commercial affiliates and subsidiaries. A major concern would be preventing nonbanking losses in affiliates from draining the resources of the insured banks. To maintain safety and soundness

in the banking system, H.R. 10 would specifically prohibit a bank from lending to a commercial affiliate and would impose a number of other restrictions. Nonetheless, experience with mixing commerce and banking in the United States has been limited. Ultimately, strong supervision and monitoring by regulators, which history has demonstrated is critical in limiting the exposure of the taxpayers during times of financial stress, would be essential to avoid additional losses to the deposit insurance fund.

If losses to the deposit insurance fund were to increase as a result of enacting H.R. 10, the BIF would increase premiums that banks pay for deposit insurance. Similarly, if losses were to decrease, banks might pay smaller premiums. As a result, the net budgetary impact is likely to be negligible over time in either case.

Conversion of Thrift Institutions. Two years after the date of enactment, all existing federal thrifts would be converted to national banks, and all state-chartered thrifts would be treated as state-chartered banks. At the same time, the OCC and the OTS would be merged, along with the bank and thrift deposit insurance funds, the BIF and the SAIF. Thrifts would no longer be required to maintain membership in the FHLB system. Finally, unitary thrift holding companies now in existence could continue to engage in all current activities, with certain limitations.

Merging the OTS and the OCC should result in long-term savings to the financial institutions that pay annual fees to cover the administrative expenses of the agencies. CBO estimates that reducing overhead and streamlining the examination process would result in cost savings of between \$10 million and \$15 million annually, once the merger is completed. The net budgetary effect of any such savings would be zero over time, however, because any reduction in expenses would result in a corresponding decrease in fee income.

Initially, CBO anticipates that the transition costs to move employees, to cover cancellations of leases, to train employees, to pay the costs of reductions-in-force, and to reprogram payroll, accounting, and other data systems, would cost about \$15 million over the 1999-2000 period. Based on information from the OTS and the OCC, we expect that the OTS would tap its existing reserve funds to pay these transition costs. Given the current OTS surplus, the agencies do not anticipate that fees paid by banks and the newly converted thrifts would be increased to replenish any reserves used for this purpose. As a result, CBO estimates that outlays would increase by \$8 million in 1999 and by \$7 million in 2000.

H.R. 10 would require about 1,100 federal thrifts to choose a new charter—either a state depository charter or a national bank charter. If no action is taken, the institution would automatically be designated a national bank. Under current law, the OCC is responsible for

regulating national banks; the Federal Deposit Insurance Corporation (FDIC) regulates state-chartered banks that are not members of the Federal Reserve System; and the Federal Reserve regulates state-chartered member banks and bank holding companies. CBO expects that most thrifts would retain their state or federal affiliation, and that most large thrifts would become national banks, thus coming under the OCC's authority. The FDIC would supervise some smaller thrifts that shift their federal charters to either state thrift or state bank charters, as well as holding companies where the lead bank is state-chartered and not a member of the Federal Reserve System. We expect that abolishing the federal thrift charter would have a minimal effect on the supervisory activities of the Federal Reserve System. In addition, all the federal regulators are likely to have some additional examination activity associated with banks and nonfinancial affiliates.

As previously noted, with the exception of transition costs, transferring supervisory responsibility for newly chartered national banks from the OTS to the OCC would have no net budget effect, because both agencies charge fees to cover all their administrative costs. That is not the case with the FDIC, however, which uses deposit insurance premiums paid by all banks to cover the expenses it incurs to supervise state-chartered banks. Because the BIF and the SAIF are well-capitalized, most banks and thrifts pay no premiums for deposit insurance at this time. Further, any increase in administrative costs triggered by H.R. 10 is not likely to result in future rate increases. CBO estimates that the FDIC would spend an additional \$2 million in 1998 and about \$18 million annually beginning in 1999 on regulatory and examination costs associated with its role in maintaining the safety and soundness of the institutions it supervises. CBO expects no significant administrative savings or costs from merging the BIF and the SAIF into a combined fund.

Other Bank Regulatory Costs. The Federal Reserve, the Securities and Exchange Commission (SEC), and state and federal banking regulators—the OCC, the FDIC, and the OTS—would have primary responsibility for monitoring compliance with the statute. The bill also would create a 10-member NCFS, headed by the Secretary of the Treasury, to determine what activities are financial in nature and which are not. It would have authority to issue regulations and to resolve disputes arising among providers of financial services. CBO estimates that the NCFS would incur costs of \$2 million to \$3 million annually. These expenses would be shared by the member agencies and largely funded by fees paid by financial institutions or by agency appropriations.

In addition, the bill would impose consumer protection regulations governing retail sales of nondeposit products and other requirements. The banking agencies would be required to establish a consumer complaint mechanism to address various complaints, to develop programs for promoting housing finance, and to implement new regulations, policies, and

training procedures related to securities, insurance and other areas. CBO expects that spending by the FDIC would total about \$1 million in 1998 and \$2 million annually for these new activities and for costs associated with monitoring compliance with the Community Reinvestment Act by the newly converted thrifts. The OCC and the OTS would also incur expenses for these purposes, but they would be offset by increased fees, resulting in no net change in outlays for those agencies.

Federal Home Loan Banks. The bill would make a number of reforms to the FHLB system, including: (1) beginning in 1999, membership in the FHLB system would become voluntary; (2) total advances that the FHLBs could issue to institutions that do not qualify as thrift lenders would no longer be capped at 30 percent; and (3) investments could not exceed the amounts necessary to ensure liquidity, safety and soundness, and support for housing finance. H.R. 10 also would replace the \$300 million annual payment made by the FHLBs for the interest on bonds issued by the REFCORP with an assessment set at 20.75 percent of the FHLBs' net income.

Based on CBO's analysis of the FHLB system's balance sheet and income statement, and using economic assumptions consistent with the budget resolution baseline, CBO estimates that the FHLBs' net earnings will peak in 1998 at \$1.3 billion and gradually drop to about \$1.1 billion by 2002. As a result, CBO estimates that the provisions affecting the FHLBs would increase their payments to REFCORP by a total of \$44 million over the 1998-2002 period. The FHLB system is a government-sponsored enterprise and its activities are not included in the federal budget. But, because the Treasury pays the interest on REFCORP bonds not covered by the FHLBs, this change would reduce Treasury outlays by \$44 million over the five-year period.

Revenues. Based on information from the Federal Reserve, we estimate that H.R. 10 would require the Federal Reserve to incur added examination costs of about \$4 million per year once the bill's requirements are fully effective in 1999. These costs would be necessary to supervise the activities of the new bank holding companies, as well as the new type of bank, the "woofie," which would not accept retail insured deposits. The Federal Reserve's cost of processing applications could also be affected. Applications for nonbanking activities could decrease but applications for the newly authorized activities of holding companies could increase. We expect that these changes would be roughly offsetting, resulting in no net budgetary impact.

Because the Federal Reserve system remits its surplus to the Treasury, changes in its operating costs would affect governmental receipts. The net effect of the changes in this bill would be to reduce governmental receipts by \$17 million over the 1998-2002 period.

Spending Subject to Appropriation

A number of federal agencies would be responsible for monitoring changes resulting from enactment of H.R. 10. CBO estimates that total costs, assuming appropriation of the necessary amounts, would be about \$1 million in 1998 and \$3 million to \$4 million annually beginning in 1999, primarily for expenses of the SEC, the Treasury, and GAO. The SEC would incur costs to monitor market conditions, to examine firms, and to investigate practices to ensure compliance with the statute. The SEC would also be required to pay a portion of the annual expenses of the NCFS. We expect these additional rulemaking, inspection, and administrative expenses of the SEC would total less than \$1 million in 1998 and about \$2 million annually beginning in 1999. The Treasury also would participate in the NCFS, and we expect that its annual costs would be about \$1 million, once the NCFS is fully staffed and operating.

H.R. 10 would require GAO to conduct an annual study evaluating competition in the financial services industry. CBO estimates that GAO would spend about \$1 million annually to collect and analyze data and prepare the report. Finally, DOJ would assume primary responsibility for streamlining the review of the antitrust implications of bank acquisitions and mergers. Based on information from DOJ, we expect that the department would continue to work with federal banking regulators to monitor such activity, and would incur no significant additional cost as a result of this change.

PAY-AS-YOU-GO CONSIDERATIONS

Section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985 sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. Legislation providing funding necessary to meet the deposit insurance commitment is excluded from these procedures. CBO believes that the various costs of H.R. 10 related to consumer protection and housing lending do not meet the exemption for the full funding of the deposit insurance commitment and thus would have pay-as-you-go implications. We estimate that direct spending changes resulting from the increase in the FDIC's supervisory costs associated with activities other than those related to safety and soundness would total about \$1 million in 1998 and \$2 million annually beginning in 1999. Costs for similar activities of the OCC and the OTS would be offset by increases in fees of an equal amount, resulting in no significant net budgetary impact for those agencies.

CBO estimates that provisions affecting the FHLBs would result in an increase in their payments for REFCORP interest and a corresponding decreasing in Treasury outlays, totaling \$109 million over the 1998-2007 period.

CBO expects that the Federal Reserve would incur additional expenses associated with consumer and housing issues that are not directly related to protecting the deposit insurance commitment. We estimate that the resulting increase in regulatory and other costs would reduce the surplus payment that the Federal Reserve remits to the Treasury by less than \$500,000 annually.

The net changes in outlays and governmental receipts that are subject to pay-as-you-go procedures are shown in the following table. For the purposes of enforcing pay-as-you-go procedures, only the effects in the budget year and the succeeding four years are counted.

	By Fiscal Year, in Millions of Dollars									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Changes in outlays										
FDIC	1	2	2	2	2	2	2	2	2	2
REFCORP payment	<u>0</u>	<u>-22</u>	<u>-17</u>	<u>-4</u>	<u>-1</u>	<u>-1</u>	<u>-4</u>	<u>-11</u>	<u>-20</u>	<u>-29</u>
Total	1	-20	-15	-2	1	1	-2	-9	-18	-27
Changes in receipts	0	0	0	0	0	0	0	0	0	0

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 10 contains several intergovernmental mandates as defined in UMRA. CBO estimates that the total cost of complying with these mandates—primarily preemptions of state laws—would be less than \$10 million a year. The bill contains other provisions, which are not mandates, but which CBO estimates would affect the budgets of state and local governments. H.R. 10 would not impose mandates or have other budgetary impacts on tribal governments.

Mandates

A number of provisions in H.R. 10 would preempt state banking and insurance laws. States would not be allowed to prevent banks from engaging in certain activities (such as selling insurance and securities) authorized under the act, nor would they be allowed to restrict the reorganization of mutual insurers. The bill would also allow federal bank regulators to enforce regulations that contradict state laws in certain circumstances. Such preemptions are mandates under UMRA. Based on information provided by the National Association of Insurance Commissioners (NAIC) and the Conference of State Bank Supervisors (CSBS), CBO estimates that enactment of these provisions would not result in direct costs or lost revenue to state governments because, while they would be prevented from enforcing certain rules and regulations, they would not be required to undertake any new activities.

Title IV of the bill would require a majority of states (within three years of enactment of H.R. 10) to enact uniform laws and regulations governing the licensing of individuals and entities authorized to sell insurance within the state. If a majority of states do not enact such laws, certain state insurance laws would be preempted and a National Association of Registered Agents and Brokers (NARAB) would be established. The purpose of the association would be to provide a mechanism through which uniform licensing, continuing education, and other qualifications could be adopted on a multistate basis. Membership in NARAB would be voluntary and open to any state-licensed insurance agent.

If NARAB is established, states would maintain the core functions of regulating insurance, such as licensing, supervising, and disciplining insurance agents and protecting purchasers of insurance from unfair trade practices, but certain state laws would be preempted. Specifically, Title IV would prevent states from discriminating against members of NARAB by charging different licensing fees based on residency and requiring compliance with countersignature laws. Based on information from the NAIC about the number of out-of-state agents and current state license fees, CBO estimates that these preemptions would result in the loss of license fees to states totaling less than \$10 million a year.

Finally, the bill would require state regulatory agencies to make available certain reports to the Federal Reserve Board and to notify the board of any significant financial or operational risk to any depository institution from the activities of an affiliate of the institution. CBO estimates that the costs of complying with these requirements would not be significant.

Other Impacts

Enactment of H.R. 10 would result in additional costs and revenues to state regulatory agencies. Certain provisions of the bill could lead to the establishment of new bank subsidiaries involved in insurance or securities activities. Because most states already allow banks to be involved in such activities, we expect that any additional costs would be small. In general, costs incurred by states would be offset by additional examination and licensing fees.

Title III also could result in additional workload for state banking agencies if federal thrifts whose charters are being abolished under the bill choose to become state-chartered financial institutions. Based on information from the CSBS, CBO estimates that any such increase in workload would be modest and that any costs would be offset by an increase in receipts from bank examination fees.

Finally, section 217 of the bill, which would expand the definition of “investment adviser” under the Investment Advisers Act, would increase the number of advisers registering with states, thereby increasing fee revenues. Based on information from the North American Securities Administrators Association (NASAA), CBO estimates that additional filing and registration fees would total approximately \$1 million annually.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

H.R. 10 would impose several private-sector mandates as defined in UMRA. CBO’s analysis of those mandates is contained in a separate statement of private-sector mandates.

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